UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF ILLINOIS

In Re	)	
	)	In Bankruptcy
FREDRIC J. KISAK	)	
	)	No. 96-41075
Debtor.	)	
	)	
DARRELL DUNHAM, Trustee,	)	
	)	
Plaintiff,	)	
	)	
v.	)	Adversary No. 97-4027
	)	
FREDRIC J. KISAK, JOYCE KISAK, JOHN KISAK, ANN KISAK,	)	
	)	
Defendants.	)	
	)	
In Re	)	
	)	In Bankruptcy
JERRY LYNN SCHUTTEK	)	
	)	No. 96-41076
Debtor.	)	
	)	
DARRELL DUNHAM, Trustee,	)	
	)	
Plaintiff,	)	
	)	
v.	)	
	)	Adversary No. 97-4061
JOYCE KISAK, JOHN KISAK, ANN KISAK, REBECCA L. SCHUTTEK,	)	
	)	
Defendants.	)	

O P I N I O N

Before the Court in the Kisak bankruptcy is the Complaint of Darrell Dunham, Trustee ("Trustee"), to set aside transfer and sell property, as amended, and the Answer thereto filed by the Defendants. Before the Court in the Schuttek bankruptcy is the Complaint of Trustee to recover interest in real estate, as amended, and the Answers thereto filed by the Defendants. Both adversary complaints relate to the same piece of property, a residential home situated on three building lots with a street address of 314 South Dent Street, Carterville, Illinois.

In 1980, Fredric J. Kisak ("Fred") and Jerry Lynn Schuttek ("Jerry") formed a partnership known as Jerred Homecrafters ("Jerred"), the purpose of which was to acquire and develop residential real estate. Fred and Jerry wanted to buy a number of building lots in Carterville; however, lacking the capital to do so, they approached John Kisak ("John") and Ann Kisak ("Ann"), Fred's parents, who gave or loaned them $15,000 for that purpose. On June 14, 1982, Jerred acquired by warranty deed Lots 9 through 18 in Carterville Milling Company's Addition to the City of Carterville ("the 1982 deed").

In 1988, Jerred constructed a home at 314 South Dent Street, Carterville, Illinois, on Lots 14, 15, and 16 ("the subject property") for John and Ann. During the construction process, John and Ann paid approximately $72,000 for the materials and labor provided in building the house. On some occasions John and Ann paid materialmen directly; on other occasions Jerred paid for materials and was reimbursed by John and Ann. On June 9, 1988, Fred and Jerry in their individual capacities only executed a Quitclaim Deed to John, Ann, Fred and Joyce M. Kisak ("Joyce"), Fred's wife, as joint tenants, conveying right, title, and interest in and to the subject property ("the 1988 deed"). John and Ann have maintained exclusive and uninterrupted possession of the subject property since 1988 and have paid all real estate taxes and insurance since 1988. The subject property has been insured in John and Ann's names only.

In October, 1993, the partnership was dissolved when Fred left Jerred because of injuries which prevented him from working in construction at that time.

On February 3, 1994, Jerry and his wife, Rebecca L. Schuttek ("Rebecca") executed a quitclaim deed to the subject property and other tracts of real estate from themselves d/b/a Jerred to themselves d/b/a Heartland Construction Company, General Contractors ("the 1994 deed")

On October 26, 1995, Fred, Joyce, John and Ann executed a quitclaim deed as grantors conveying their interest in the subject property to John and Ann as tenants by the entirety and to Joyce as joint tenant ("the 1995 deed") . The purpose of this deed was to remove Fred's name from the title. Jerred, Fred, and Jerry had been sued by and had countersued a Dr. Harryman. Joyce, a paralegal at the law firm of Feirich/Mager/Green/Ryan in Carbondale, Illinois, was advised by Mary Lou Rouhandeh, one of the attorneys for whom she worked, that it would be advisable to remove Fred's name from the title. Ms.

Rouhandeh testified that Joyce mentioned that Fred was involved in litigation and that she was concerned about the effect of an unfavorable outcome. Joyce disclosed that she and Fred had been put on the title of John and Ann's house as an estate planning device to avoid probate. Joyce further stated that she did not want anything that might happen in Fred's litigation to affect his parents' property. Subsequently, Ms. Rouhandeh prepared the 1995 deed.

On September 3, 1996, both Fred and Jerry filed an individual petition in bankruptcy seeking relief under Chapter 7 of the Bankruptcy Code.

The Trustee filed an adversary complaint in the Kisak bankruptcy alleging that Fred's execution of the 1995 deed was a fraudulent conveyance under Section 548 of the Bankruptcy Code. The Trustee further asserts that because the 1988 deed was executed by Fred and Jerry individually rather than on behalf of Jerred, the conveyance was ineffective as against a hypothetical bona fide purchaser and, pursuant to the "strong arm clause" of Section 544 (a) (3) , his claims on behalf of the Kisak and Schuttek bankruptcy estates are superior to any claim of interest by any of the Defendants. Section 548 states as follows:

> (a) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily–
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> (1) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or
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> (2) (A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
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> (B) (i) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation(.)
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> . . . .

In order to recover under Section 548(a), Trustee must show the following essential elements: (1) a transfer of the Debtor's property or an interest therein; (2) made within one year before the date of the

filing of the bankruptcy petition; (3) made with actual intent to hinder, delay or defraud a creditor of the Debtor; or (4) for which the Debtor received less than reasonably equivalent value in exchange for the transfer; and (5) the Debtor was insolvent when the transfer was made or was rendered insolvent thereby. In re Bright, 1994 WL 698490 at 4 (Bankr. N.D. Ill.).

While it is undisputed that Fred's execution of the 1995 deed was within one year of the filing of his bankruptcy petition, the Court finds that Fred's execution of the 1995 deed did not convey Debtor's property or an interest therein. While the definition of "property of the estate" set forth in 11 U.S.C. § 541 is quite broad and is intended to be interpreted liberally, the facts in this case clearly show that Fred's interest in the subject property was that of a bare legal titleholder. Under Section 541(d) of the Bankruptcy Code, where the debtor holds bare legal title without any equitable interest, the bankruptcy estate acquires bare legal title without any equitable interest in the property. 11 U.S.C. § 541 (d) Congressional Record Statements (Reform Act of 1978), 124 Cong Rec H11096 (daily ed. Sept. 28, 1978); remarks of Rep. Edwards).

The evidence in this case demonstrated that Fred was the only son of John and Ann, and that Fred and Joyce have a particularly close relationship with John and Ann. The 1988 deed listed Fred and Joyce as joint owners only for estate planning purposes as they were the natural and logical heirs of John and Ann. Neither Fred nor Joyce thought they had any ownership interest in the subject property. Neither Fred nor Joyce ever lived in the property, ever paid real estate, insurance or utility bills related to the property, or ever acted in a way which would have indicated that they had or thought they had a present or future ownership interest or any type of dominion or control over the property. Therefore, when Fred executed the 1995 deed, he was not conveying away any equitable ownership interest in the subject property because he had already conveyed that interest when he and Jerry executed the 1988 deed. The purpose of the 1995 deed was merely to sever a joint tenancy and remove the name of Fred, a joint tenant with no equitable ownership interest. The Court is unaware of any authority for the proposition that the severing of a joint tenancy constitutes a fraudulent conveyance where the grantor held only bare legal title and no economic interest.

Even if the subject property were deemed to be property of the estate, the Court finds that the estate's interest in the property, which is that of bare legal titleholder with no equitable ownership interest, has no value whatsoever. Accordingly, the transfer of Fred's purported interest in the property does not satisfy the requirement of § 548 (a) (2) (A) in that the transfer was for reasonably equivalent value as Fred received nothing in exchange for an interest which was worth nothing.

Accordingly, the transfer was not a fraudulent conveyance and cannot be avoided by the Trustee.

In addition, the Court finds that Fred did not execute the 1995 deed with any intent to hinder, delay or defraud a creditor in violation of § 548 (a) (1) . While it is acknowledged that Fred, Jerry and Jerred had been named as defendants in a civil lawsuit prior to the transfer, there was no subjective expectation on Fred's part at the time that he would not prevail in the lawsuit. Further, the testimony at trial, which the Court finds credible, indicated that Fred did not believe that he had any ownership interest in the subject property at the time - he believed he had conveyed away his ownership interest with the 1988 deed. It is inferential that one cannot possess the requisite intent-to hinder, delay, or defraud when one purports to disclaim an interest in property in which one does not believe one has an equitable ownership interest. The Court accepts as true Fred's testimony that the 1995 deed was executed for the sole and express purpose of keeping John and Ann's property out of Fred's legal problems. Finally, and significantly, there is no evidence in the record to suggest that Fred was insolvent when the transfer was made or that the transfer rendered him insolvent. Hence, the requirement of § 548 (a) (2) (B) (i) has not been satisfied.

Section 541 (d) of the Bankruptcy Code states in part as follows:

> (d) Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest . . . becomes property of the estate . . . only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

Section 205/10(2) of the Illinois Uniform Partnership Act, 805 ILCS 205 et seq., provides in part as follows:

> (2) Where title to real property is in the name of the partnership, a conveyance executed by a partner, in his own name, passes the equitable interest of the partnership . . . .

Reading the two quoted statutes above together, the Court finds that Fred and Jerry conveyed Jerred's equitable interest in the subject property when they executed the 1988 deed individually. Hence, under § 541 (d), neither bankruptcy estate has an equitable interest in the subject property derived from any interest which Jerred may have had.

Section 541(d) of the Bankruptcy Code also excludes property subject to a constructive trust

from the bankruptcy estate and overcomes the trustee's strong arm powers. Matter of Haber Oil Co., 12 F.3d 426, 435-36 (5th Cir. 1994). A constructive trust is a remedy for unjust enrichment, not a real trust. In re Omegas Group, Inc., 16 F. 3d 1443, 1449 (6th Cir. 1994). It is created when a court declares a party has wrongfully acquired property as the constructive trustee of that property. Suttles v. Vogel, 126 Ill.2d 186, 193. A constructive trust is an equitable remedy imposed by a court to prevent the unjust enrichment of a party through actual fraud or breach of a fiduciary relationship. In re Liquidation of Security Casualty Co., 127 Ill.2d 434, 447 (1989). A constructive trust can be enforced against a bankruptcy trustee, notwithstanding his status as a bona fide purchaser pursuant to § 544 (a) (3). In re Fieldcrest Homes, Inc., 18 B.R. 678, 679 (Bankr. N.D. Ill. 1982); In re Haber Oil , *supra* at 436 *citing* In re Emerald Oil Co., 807 F.2d 1234, 1238 (5th Cir. 1987); Matter of Quality Holstein Leasing, 752 F.2d 1009, 1012-15 (5th Cir. 1985). *See also* Universal Bonding Ins Co. v. Gittens and Sprinkle Enter, Inc., 960 F.2d 366, 372 (3d Cir. 1992).

It is clear to the Court that to whatever extent Fred or Jerry had an ownership interest in the subject property after June 9, 1988, the date upon which they executed the deed to the subject property as grantors, that from that date forward they held that interest as constructive trustees for John and Ann. As of June 9, 1988, Jerred had been paid in full by John and Ann for all labor and materials provided in the construction of the subject property. Any attempt on the part of Fred or Jerry to assert dominion or control over the subject property after June 9, 1988, would have been wrongful, tortious, and fraudulent. As a trustee takes only a debtor's interest in property under § 541 (d), and as Fred and Jerry had no interest in the subject property other than as constructive trustees, the Court finds that the subject property is not property of either debtor's estate.

Section 544 (a) (3) of the Bankruptcy Code states as follows:

> (a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by--
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> . . .

> (3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists.

The "strong arm clause" of § 544 (a) (3) gives a bankruptcy trustee the power to avoid certain transfers or liens against the property of the estate. The Trustee argues that because the 1988 deed was executed by Fred and Jerry individually and not as partners of and on behalf of Jerred, the deed is ineffective as against a hypothetical bona fide purchaser because its recording did not give sufficient notice of the transfer.

James W. Morris, an attorney and owner and operator of title companies, testified that the 1988 deed would not appear in the chain of title in a search of a grantor/grantee index because the subject property was conveyed in 1982 to Jerred, a partnership. Therefore, if one were searching for conveyances of the subject property in a grantor/grantee index after the original conveyance to Jerred in 1982, one would be searching for conveyances by a grantor named Jerred. Because the 1988 deed is from Fred and Jerry and not from Jerred, Mr. Morris testified, the 1988 deed would be out of the chain of title in the absence of some other curative information which would connect Jerred with Fred and Jerry.

Mr. Morris conceded that he might very well have found the 1988 deed if he had been examining the title of the subject property, although such an outcome was not absolutely certain. Mr. Morris admitted that the fact that the grantee of the 1962 deed was an assumed name entity, in this case a partnership, would have led a good title searcher to take further steps in searching the title in addition to checking the grantor/grantee index. Mr. Morris testified that such "wild deeds" generally appear in an abstract because most title companies compiling abstracts do so from a tract index system which is a system of records that is customarily maintained by title companies and is separate and apart from the grantor/grantee index. Hence, in a tract index system, it would be very likely that such a “wild deed” which describes a particular parcel of property would be discovered and shown even though it was made by a "stranger".

The Court does not accept Trustee's conclusion that the recording of the 1988 deed constituted

insufficient notice to defeat him as a hypothetical bona fide purchaser under § 544 (a) (3). However, even if Trustee's argument on whether the deed constituted sufficient notice were accepted, the Court would still find that Trustee would not prevail as a hypothetical bona fide purchaser because even if notice from the recording of the 1988 deed was insufficient, Trustee still had sufficient constructive notice of adverse claims of interest.

In In re Probasco, 839 F.2d 1352 (9th Cir. 1988), a debtor in possession ("DIP") sought to utilize the strong arm powers of § 544 (a) (3) to avoid an unrecorded interest in real property. The Eleventh Circuit held that the DIP's constructive notice of an unrecorded interest precluded avoidance. The court held that actual or constructive notice of a prior unrecorded transfer removes a subsequent purchaser from the protection of the recording acts. Clear and open possession of real property constitutes constructive notice of the rights of the party in possession to subsequent purchasers. Such a prospective purchaser must inquire into the possessor's claimed interest, whether equitable or legal. Therefore, a bona fide purchaser does not take priority over one in clear and
open possession of real property. Id. at 1354.

In this case, John and Ann have been in uninterrupted and exclusive possession of the subject property since 1988. They have paid all real estate taxes on the subject property since 1988 and their occupancy of the subject property has been open, continuous, adverse, and exclusive. Under the Probasco doctrine, constructive notice by open possession is as relevant as constructive notice by recorded instrument to evidence a competing claim of title to real property. Id. at 1354-55 *citing* In re Gurs, 27 B.R. 163, 165 (9th Cir. BAP 1983); McCannon v. Marston, 679 F. 2d 13, 16 (3d Cir. 1982); In re Heinig, 64 B.R. 456, 458 (Bankr. S.D. Cal. 1986). This Court accepts this doctrine, particularly under the facts of this case, and finds that a hypothetical bona fide purchaser would have sufficient notice of a competing claim of ownership of the subject property.

Finally, the Court finds that, as a court of equity, it has the inherent right to declare the validity of a proven claim of ownership when a third party asserts and proves such ownership in the face of a trustee's assertion under § 544 (a) (3). This has been done in this case, and the Court finds that John and

Ann Kisak are now and have been since June 9, 1988, the sole owners of the subject property.

For all of the reasons set forth above, Trustee's complaints are denied.

This Opinion is to serve as Findings of Fact and Conclusions of Law pursuant to Rule 7052 of the Rules of Bankruptcy Procedure.

See written Order.

ENTERED: February 27, 1998

/s/ LARRY LESSEN
UNITED STATES BANKRUPTCY JUDGE